R 221039Z JAN 09
FM AMEMBASSY CHISINAU
TO SECSTATE WASHDC 7535
DEPT OF TREASURY WASHINGTON DC
DEPT OF COMMERCE WASHINGTON DC
CIM NTDB WASHINGTON DC
INFO EUROPEAN POLITICAL COLLECTIVE

UNCLAS CHISINAU 000043

STATE FOR EB/IFD/OIA AND EUR/UMB
BUCHAREST FOR FCS
KYIV FOR FCS
SOFIA FOR FAS
STATE PASS OPIC

E.O. 12958: N/A
TAGS: EINV EFIN ETRD PGOV KTDB OPIC USTR MD
SUBJECT: MOLDOVA 2009 INVESTMENT CLIMATE STATEMENT
(PART 1 OF 2)

REF: 08 STATE 123907

¶1. Embassy Chisinau submits the Investment Climate Statement in response to reftel:

Openness to Foreign Investment

¶2. Moldova continues to take small steps toward developing a stronger economy, reforming a cumbersome regulatory framework, combating corruption and adopting reforms aimed at improving the business climate. Poor physical infrastructure, cumbersome licensing procedures, excessive permit requirements, and proliferation of fee-for-services to public authorities and commercial organizations all contribute to a business environment that remains among the most challenging in the region. For example, in the Doing Business Dealing with Construction Permits indicator, Moldova ranks 158th out of 176 economies and requires twice as many procedures as the average for OECD countries.

¶3. Corruption is a serious concern and "unofficialQ payments are widespread. An American investor recently encountered numerous bureaucratic obstacles in attempting unsuccessfully to renew a license. Government tax authorities conducted an extensive audit of the investor's company during the same period, in a reminder of the government's power to harass existing investors and keep them in suspense. The company was found to be in compliance with tax laws but had to invest staff time and effort to comply with the audit. The Embassy has also received reports of targeted actions by politically connected individuals against profitable businesses. These measures include abusive inspections and opaque administrative sanctions. Major foreign investors have also complained about the government's lack of willingness to engage in constructive dialogue on important issues affecting the business community.

¶4. After a prolonged recession in the 1990s, GDP has grown for seven straight years and inflation has decreased. Moldova, which is consistently ranked among the poorest countries in Europe, relies heavily on investments, foreign trade, and remittances sent by Moldovans working abroad, for economic growth. Remittances equaled 38 percent of GDP in 2007. Recent years have seen an increase in foreign direct investment (FDI) as investors have taken advantage of the eastward expansion of the European Union (EU), which now

borders Moldova following the January 1, 2007, accession of Romania. The Government of Moldova (GOM) has made efforts to tackle some obstacles to investment, such as corruption and red tape. Furthermore, Moldova has declared European integration a strategic objective. The country had an Action Plan with the EU that set out a roadmap for democratic and economic reforms and the harmonization of Moldovan laws and regulations with European standards.

¶5. Moldova has been a member of the WTO since 2001 and has signed free trade agreements with countries of the former Soviet Union (CIS) and Southeast Europe. In December 2006, Moldova joined the Central European Free Trade agreement (CEFTA). Moldova benefits from an extended generalized system of preferences (GSP-plus) with the EU. Starting in March 2008 the EU unilaterally granted Moldova autonomous trade preferences, which expanded the duty-free access of Moldovan goods to EU markets. Moldova also seeks to further deepen its preferential trade arrangements with European markets in the negotiation of a new EU agreement.

¶6. The GOM has created an adequate legal base, including favorable tax treatment for investors. Under Moldovan law, foreign companies enjoy the same treatment as local companies (national treatment principle). The GOM views investments as vital for sustainable economic growth and poverty reduction. However, the amount of foreign direct investment (FDI) is far below the countryQs needs. In attracting FDI, the GOM continues to add incentives. In 2008 the GOM introduced zero tax on business profit reinvested in a business.

¶7. After years of low FDI due to a weak business climate, FDI inflows have been steadily increasing since 2004. In 2007, FDI inflows amounted to USD 537.7 million, representing almost half of total FDI stock since Moldova's independence in 1991. In the first nine months of 2008, FDI amounted to USD 627.4 million. Recent years have seen large investments by Germany's Metro Cash & Carry, Germany's Draexlmaier, FranceQs Societe Generale, Austria's Grawe insurance company, AustriaQs Raiffeisen Investment, the Netherlands' Easeur Holding B.V., Italy's Veneto Banca, and the U.S. investment fund NCH Capital.

¶8. The GOM states on its website that one of its primary tasks is to attract investments and create a favorable business climate for all investors both foreign and local ones. The GOM claims it taking measures to stimulate the business activity and improve the investment climate focusing on the country's geographical position, labor resources, fertile soils and participation in free trade agreements with the CIS countries and the EU. American investments in Moldova are primarily in the wine and food industry, cosmetics, telecommunications, banking and real estate.

¶9. Despite some GOM efforts to lower tax rates, strengthen tax administration, increase transparency and simplify business regulations, decision-making remains opaque and the application of regulations inconsistent. Additionally, on occasion, government officials interfere in business decisions in favor of a protected individual, use governmental powers to pressure businesses for personal or political gain, and selectively apply regulations. Since the judicial system remains weak, recourse to the courts does not guarantee citizens and foreign investors an impartial ruling on alleged governmental misdeeds.

¶10. In December 2007 the Moldovan Parliament adopted the National Development Strategy (NDS). The NDS succeeded the Economic Growth and Poverty Reduction Strategy (EGPRSP) of 2004-2007. The NDS was developed in broad-based consultations with stakeholders and civil society. The NDS defines the GOM's developmental objectives and will guide the budgetary process over the period 2008-2011. Attracting FDI is critical to enhancing one of the pillars of the NDS, namely enhancing the competitiveness of the national economy. This pillar focuses on policies to improve the business environment in order to encourage more investment activity, technological innovation and modernization; promote the expansion of the small- and medium-enterprise sector; increase labor productivity; improve state asset management; promote inclusion into international networks; address MoldovaQs deteriorating physical infrastructure; and reduce its energy vulnerability. In 2006, after a five-year intermission, the GOM resumed financial relations with the IMF by signing a Memorandum of Economic and Financial Policies that included criteria for the improvement of macroeconomic indicators, infrastructure development and better state property management. In coordination with the IMF, the GOM has introduced budgets with low deficits and made reducing inflation a goal. In 2008 the GOM held inflation under ten percent for the first time since 2002. The memorandum expires in June 2009 and the GOM has not decided whether to renew its cooperation with the IMF.

¶11. The Constitution of the Republic of Moldova guarantees the inviolability of investments by all natural and legal entities, including foreigners. Key constitutional principles include the supremacy of international law, a market economy, private property, provisions against unjust expropriation, provisions against confiscation of property, and separation of powers among government branches. The Constitution provides for an independent judiciary; however, government interference and corruption remain problems in the application of laws and regulations and in the impartiality of the courts.

¶12. Current investment legislation is based on nondiscrimination between foreign and local investors. Moldovan law ensures full and permanent security and protection of all investments, regardless of their form, although application of the law remains spotty. There are no economic or industrial strategies that have a discriminatory effect on foreign-owned investors in Moldova, and no limits on foreign ownership or control, except in the right to purchase and sell agricultural and forest land, which is restricted to Moldovan citizens.

¶13. International treaties and Moldovan law regulate business activity, including foreign investments. Such laws include, but are not limited to, the Civil Code, the Law on Property, the Law on Investment in Entrepreneurship, the Law on Entrepreneurship and Enterprises, the Law on Joint Stock Companies, the Law on Small Business Support, the Law on Financial Institutions, the Law on Franchising, the Tax Code, the Customs Code, the Law on Licensing Certain Activities, and the Law on Insolvency.

¶14. The Law on Investment in Entrepreneurship came into effect on April 23, 2004, superseding the previous Law on Foreign Investment. It was designed to be compatible with European

legislative standards and defines types of local and foreign investment. It also provides guarantees for the respect of investors' rights, non-application of expropriation or actions similar to expropriation, and for payment of damages in the event investors' rights are violated.

¶13. There is no screening of foreign investment in Moldova and legislation permits 100 percent foreign ownership in companies. By statute, special forms of legal organizations and certain activities require a minimum of capital to be invested (e.g., Moldovan Lei (MDL) 5,400 for limited liability companies, MDL 20,000 for joint stock companies, MDL 15 million for insurance companies and MDL 50 million for banks). The current rate of exchange is 10.4 MDL per USD.

¶15. The Law on Investmentin Entrepreneurship permits investment in all setors of the economy. Certain activities require abusiness license.

¶16. The Law on Entrepreneurship and Enterprises permits only state enterprises to participate in the following activities:
- Some types of human and animal medical research;
- Manufacture of orders and medals;
- Production of symbols verifying payment of state taxes and fees;
- Postal services (except express mail) and production of postage stamps;
- Sale and production of combat and special military technical equipment, explosives (except gun powder) and all weapons;
- State registry, tracking and technical inventory of real estate, restoration of ownership titles and administration of real estate;
- Printing and minting of currency and printing of state securities; and
- Certain scientific activities.

¶17. The GOM launched the first privatization process in 1994. It has adopted three different privatization programs since that time, including privatization via National Patrimonial Bonds (foreigners were not allowed to participate); via cash transactions for both locals and foreigners; and via a program which involved only cash privatization. The third program began in 1997-1998 and was extended to 1999-2000. The program was later extended with some modifications to the end of 2006. Foreign investors have successfully participated in these privatizations. In 2007, Parliament passed a new privatization law which introduced a new plan for privatizing and managing state-owned assets with a priority on economic efficiency. The law has a list of assets not subject to privatization. The GOM also adopted regulations on the privatization of state-owned non-agricultural land through commercial tenders. A list of assets subject to privatization has been approved.

¶18. The GOM has privatized most state-owned enterprises, and some sectors of the economy are almost entirely in private hands. However, some large enterprises are still controlled by the government and their privatization has been either postponed indefinitely or abandoned altogether. The major government-owned enterprises are two northern electrical distribution companies, the Chisinau heating companies, the fixed-line telephone operator Moldtelecom, the state airline Air Moldova and the majority state-owned bank Banca de Economii. After a period of abated privatization activity consisting of a selloff of residual governmental shares in companies

originally sold during the mass privatizations of the 1990s, the GOM picked up efforts to sell a series of attractive assets. In 2008, the GOM privatized the footwear manufacturer Zorile, the former Soviet military-industrial complex Mezon, and the hotel Codru. Many have questioned the sales which sometimes appear to proceed at rates far below market price. The GOM does not promote transparency in how it evaluates bids. At times the announcements and very short deadlines for submitting make it difficult for potential bidders to arrange financing and comply with all the requirements for bids. It may seem that only bidders with previous knowledge of the sale may be able to comply with bid requirements.

¶19. The Law on Investment in Entrepreneurship prohibits discrimination against investments based on citizenship, domicile, residence, place of registration, place of activity, state of origin or any other grounds. The law provides for equitable and level-field conditions for all investors. It rules out discriminatory measures hindering the management, operation, maintenance, utilization, acquisition, extension or disposal of investments. Local companies and foreigners are to be treated equally with regard to licensing, approval, and procurement.

¶20. In recent years, the GOM made significant efforts to streamline business registration. In the business registration procedure, the GOM simplified document submissions by implementing a "one window" approach. This process reduced the number of documents and days necessary for business registration. Limited on-line business-registration services were introduced in 2006 and
¶2007. In the business licensing procedure, the government simplified the process in 2002 by establishing one authority in charge of business licensing -- the Licensing Chamber -- and by reducing the number of business activities that require licensing. The GOM plans to streamline the permit process for entrepreneurial activity and introduce elements of the "one-window" approach in the activities of public authorities, including their electronic interconnection to facilitate the exchange of electronic data.

Currency Conversion and Transfer Policies

¶21. Moldova accepted Article VIII of the IMF Charter in 1995, which required liberalization of current foreign exchange operations. There are no restrictions on the conversion or transfer of funds associated with foreign investment in Moldova. After the payment of taxes, foreign investors are permitted to repatriate residual funds. Residual-funds transfers are not subject to any other duties or taxes, and do not require special permission. There are no significant delays in the remittances of investment returns, since domestic commercial banks have accounts in leading multinational banks. Companies are not obliged to sell their hard currency earnings to the government. Foreign investors enjoy the right to repatriate their earnings.

¶22. Generally, there are no difficulties associated with the exchange of foreign or local currency in Moldova. However, shortages of Moldovan currency in the banking system have occurred in the past. While the local currency, the Moldovan Leu (plural, Lei) (MDL), has been generally stable. The Moldovan Leu has been strengthening in recent years owing to the weakness of the U.S. dollar, a massive surge in

remittances, and changes in monetary policies. The Leu appreciated from MDL 11.3 to 10.4 per U.S. dollar over the course of 2008.

¶23. The U.S. Embassy has no information on complaints from U.S. investors regarding converting or remitting funds associated with investments in Moldova.

Expropriation and Compensation

¶24. The Law on Investment in Entrepreneurship states that investments cannot be subject to expropriation or measures with a similar effect. An investment may be expropriated only if all three of the following conditions are present: the expropriation is done for purposes of public utility, is not discriminatory, and is done with just and preliminary compensation. If a public authority violates an investor's rights, the investor is entitled to reparation of damages. The compensation will be equivalent to the real extent of the damage at the time of occurrence. The public authorities concerned will pay compensation for any damage caused, including any lost profits. Compensation must be paid in the currency in which the original investment was made or any other convertible currency, if the investment was made in a convertible currency. Public authorities may provide investors additional guarantees beyond those described in the law.

¶25. The government has given no evidence of intent to discriminate against U.S. investments, companies, or representatives by expropriation or of intent to expropriate property owned by citizens of other countries. No particular sectors are at greater risk of expropriation or similar actions in Moldova.

¶26. Moldovan law restricts the right to purchase agricultural and forest land to Moldovan citizens. Foreigners may become owners of such land only through inheritance and may only transfer the land to Moldovan citizens. In 2006, Parliament further restricted the right of sale and purchase of agricultural land to the state, Moldovan citizens and legal entities without foreign capital. However, foreigners are permitted to buy all other forms of property in Moldova, including land plots under privatized enterprises and land designated for construction. Moldovan-registered companies with foreign capital are known to own agricultural land, by means of loopholes in the previous law. There have been some reports that the newer limit on foreign ownership of agricultural land was used in lawsuits as an argument against foreign companies. The only option available to foreigners who desire to obtain agricultural land in Moldova at this time is to rent agricultural land.

¶27. Since 2001, the GOM has cancelled several privatizations, citing the failure of investors to meet investment schedules or irregularities committed during privatization. While the government agreed to repay investors in such disputes, payment of compensations was delayed. Often, investors have had to apply to the European Court of Human Rights (ECHR) to enforce payment of compensation from the Moldovan government. The GOM has been generally compliant with the ECHR rulings involving foreign businesses.

¶28. Investors should be aware that Moldovan territory east of the Nistru (Dniester) River is

under the control of a separatist regime that does not recognize the sovereignty of the legitimate Moldovan authorities in Chisinau. These separatists have declared a self-proclaimed "Dniester Moldovan Republic," commonly known as "Transnistria." The U.S. Embassy regularly warns potential investors who are considering doing business in Transnistria that the Embassy is extremely limited in its ability to provide any assistance there, including consular and commercial services. Also, the GOM has indicated that it will not recognize the validity of contracts for the privatization of firms in Transnistria that are concluded without the approval of the appropriate Moldovan authorities. In March 2006, Ukraine imposed new customs regulations under which Transnistrian companies seeking to engage in cross-border trade had to register in Chisinau. Despite initial protests by the local regime, most of TransnistriaQs large companies subsequently registered with Moldovan authorities.

¶29. In 2000, a U.S. company claimed that it exported packing equipment and other capital goods to a privatized Transnistrian factory, only to be forced out later by the local factory manager working in collusion of local authorities. The company's representatives reported that they had been harassed by Transnistrian authorities until they decided that the safety of their company's employees could not be guaranteed and the company decided to pull out.

Dispute Settlement

¶30. Moldova has a record of disputes over past privatizations involving foreign investors. Party of Communists (PCRM) officials, when in opposition prior to 2001, were critical of what they regarded as "sweet-heart deals" in many privatizations. Consequently, once in power, the first government appointed by the PCRM in 2001 increased its scrutiny of the privatization process, including previously concluded contracts. The GOM cancelled some privatizations because of alleged irregularities in the privatization procedures or the failure of investors to meet an investment timetable. In order to ensure the predictability and credibility of the government's privatization policy, the GOM has attempted to introduce a statute of limitations of three years on the investigation of privatization files. There have been reports in recent years from companies that they had become targets of investigations by the Center for Combating Economic Crimes and Corruption (CCECC), while others complained of bureaucratic red tape or arbitrary decisions made by government agencies, police or tax authorities.

¶31. As a result of negotiations connected with Moldova's accession to the WTO, modern commercial legislation was adopted in accordance with WTO rules. In recent years the GOM has taken opaque measures, which violate WTO commitments, to protect domestic producers from foreign competitors. For example, the GOM has introduced an environmental tax on bottles and other packaging of imported goods, while not taxing bottles and packaging produced in Moldova. The Embassy interprets this measure to be a non-tariff barrier to trade. The Ministry of Economy and Trade stated it had informed the WTO of the measure and not received a reply.

¶32. In 2003, the government restructured the judiciary by eliminating the lower-tier of appellate courts (called tribunals) and the Higher

Court of Appeals. The judiciary now consists of lower courts (i.e., trial courts), five courts of appeals, and the Supreme Court of Justice. Moreover, a separate set of courts covering the judicial settlement of economic/trade-related litigations was created. This quasi-separate court system consists of the District Economic Court as a trial court, the Economic Court of Appeals, and the Supreme Court of Justice, whose jurisdiction includes the adjudication of economic litigations. Courts are nominally independent from government interference. However, the Ministry of Justice controls their administration and budget, and reports of interference in law suits by influential figures are commonplace. In January 2008, a new department was created under the Ministry of Justice - the Judicial Administration Department Q which deals with all judiciary-related administrative and financial matters. Moldovan courts suffer from low levels of efficiency, independence and citizen trust. During 2008, several lawyers representing Moldovan nationals at the European Court of Human Rights claimed that some judges are loyal to the government and that government officials influence their decisions.

¶33. The GOM accepts binding international arbitration of investment disputes between foreign investors and the state. By law, investment disputes can be solved through Moldovan courts or arbitration. In the event of ad hoc arbitration, the law requires following United Nations Commission on International Trade Law (UNCITRAL) rules, arbitration rules of the Paris International Chamber of Commerce (ICC) of January 1, 1998, and other rules, principles and norms agreed upon by the parties.

¶34. Moldova is a signatory to the Convention on the International Center for the Settlement of Investment Disputes (ICSID - Washington Convention) and the New York Convention of 1958 on the Recognition and Enforcement of Foreign Arbitral Awards. Moldova is also a party to the Geneva European Convention on International Commercial Arbitration of April 21, 1961, and the Paris Agreement relating to the application of the European Convention on International Commercial Arbitration of December 17, 1962. Moldova has also ratified various trade agreements establishing bilateral investment protection with 35 countries (see paragraph 73), including with the United States. Moldova enjoys normal trade relations with the United States.

Performance Requirements/Incentives

¶35. Any incentives are applied uniformly to both domestic and foreign investors. Unlike the previous law, the new Law on Investment in Entrepreneurship no longer protects new investors from legislative changes for ten years. However, the new law left in effect past privileges and guarantees granted to foreign investors according to the old Law on Foreign Investment. One such privilege provides for exemptions from customs duties on imports until April 23, 2014, if the imports are used to manufacture goods bound for export.

¶36. Effective January 1, 2008, a zero percent income tax rate on re-invested corporate profits entered into force as part of a GOM initiative of "economic liberalization." The current Moldovan Tax Code also provides for a series of corporate income tax breaks. Many of these tax breaks were

rendered redundant when the new zero tax rate was introduced. Companies with investments of more than USD 250,000 in charter capital enjoy a 50 percent exemption from income tax for five consecutive years. Companies with investments exceeding USD 2 million in charter capital enjoy full exemption from income tax for three consecutive years. Companies are eligible for such exemptions, if at least 80 percent of their income-tax payments were reinvested in production development or in national or sectoral development programs. For a minimum investment of USD 5 million, a company is exempt for three years from income-tax payments, if it reinvests locally 50 percent of what it would otherwise have paid in income tax. A USD 10 million investment requires only 25 percent reinvestment of income-tax payment for a full three-year exemption from income tax. Four-year exemptions are available for a USD 20 million investment with 10 percent reinvestment and for a USD 50 million investment with zero percent reinvestment. Furthermore, upon expiration of these exemptions, eligible companies investing an additional USD 10 million can enjoy tax exemptions for an extra 3-year period. Also, fixed assets contributed in-kind to the charter capital are exempted from the value-added tax and customs duties. Full income tax exemptions may also be enjoyed by small businesses (three years), software developers (five years), agribusiness (five years), and scientific research and innovations (unspecified). Commercial banks and microfinance organizations are tax exempt on income derived from loans with maturities over three years. Other tax exemptions and deductions are also available according to the Tax Code. The loss carry-forward period was raised from three to five years.

¶37. No formal requirements exist for investors to purchase from local sources or to export a certain percentage of their output. Informally, however, such requirements, often decided in an arbitrary and non-transparent basis, have been imposed by Moldovan authorities in some industries to serve short-term goals.

¶38. No limitations exist on access to foreign exchange in relation to a company's exports. There are no special requirements that nationals own shares of a company. Both joint ventures and wholly foreign-owned companies may be set up in Moldova. However, individual privatization projects in sectors such as energy, telecommunications, wine, and tobacco may have specific performance requirements. In a previous unsuccessful effort to privatize a power plant in the northern part of Moldova in 2001, the GOM required bidders to have experience with electricity distribution activity in free market conditions and to have work experience in developing countries. In 2002 the GOM attempted to privatize the monopoly telephone company, Moldtelecom. GOM required bidders to have experience servicing at least 1,000,000 customers, an annual turnover at least USD 150,000,000, asset values of at least USD 300,000,000 and experience in developing countries.

¶39. Foreign and local investors are nominally treated the same.

¶40. The government does not impose "offset" requirements on procurements. Moldovan law allows investments in any area of the country in any sector, provided that national security interests, anti-monopoly legislation, environmental protection, public health, and public order are

respected.

¶41. Enforcement procedures for performance requirements to enjoy tax incentives are described in the Tax Code and related governmental decisions and Ministry of Finance instructions.

¶42. Foreign investors are required to disclose the same information as local ones. Moldova has no discriminatory visa, residence, or work-permit requirements inhibiting foreign investors' mobility in Moldova. However, the government administers a quota system limiting the number of available residence permits. The Embassy receives regular complaints that the issuance process for work and residence permits is unnecessarily complicated and seemingly arbitrary.

¶43. Moldova has commercial relations with over 100 countries. It has a liberal commercial regime. According to the Tax Code, Moldovan exports are exempt from value added tax.